

## Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 LONDON 09104

E.O. 11652: GDS

TAGS: ENRG, UK

SUBJECT: WHITE PAPER ON UK OFFSHORE OIL AND GAS POLICY:  
A PRELIMINARY ASSESSMENT

REF: LONDON A) 8800, B) 8680, C) 8688

BEGIN SUMMARY: AS OUTLINED IN WHITE PAPER JULY 11,  
LABOUR GOVERNMENT INTENDS TO ACQUIRE MAJORITY PARTICIPA-  
TION IN NORTH SEA OIL OPERATIONS, TO RAISE TAXES ON NORTH  
SEA COMPANIES, AND TO ENLARGE ITS REGULATORY POWERS WHERE  
NORTH SEA OIL IS CONCERNED. ALTHOUGH MANY OF THESE  
MEASURES WERE EXPECTED, THE OIL COMMUNITY HAS REACTED  
CAUTIOUSLY, CLEARLY PREFERRING TO WAIT AND SEE WHAT  
SPECIFIC PROPOSALS THE GOVERNMENT WILL MAKE EITHER IN  
NEGOTIATIONS WITH INDIVIDUAL COMPANIES OR IN THE COURSE  
OF AN ELECTION CAMPAIGN NOW WIDELY EXPECTED FOR SEPTEMBER/  
OCTOBER. END SUMMARY

1. SEC STATE FOR ENERGY ERIC VARLEY'S REPORT TO PARLIA-  
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MENT ON JULY 11 SET FORTH HMG'S POSITION ON UNITED KING-

DOM OFFSHORE OIL AND GAS POLICY. THE WHITE PAPER STATED GOVERNMENT HAD TWO MAIN OBJECTIVES; TO OBTAIN A FAIRER TAX SHARE OF CONTINENTAL SHELF OIL AND GAS PROFITS, WITH SPECIAL CONSIDERATION FOR SCOTLAND (AND LATER WALES); AND TO ASSERT GREATER PUBLIC CONTROL. TO ACCOMPLISH THESE OBJECTIVES, SIX SPECIFIC ACTIONS WERE ANNOUNCED:

1. AN ADDITIONAL TAX ON THE COMPANIES' PROFITS FROM THE CONTINENTAL SHELF AND THE CLOSING OF VARIOUS LOOPHOLES IN THE RULES ON EXISTING TAXATION ON THEIR PROFITS WILL BE PROPOSED.

2. IT WILL BE A CONDITION OF FUTURE LICENCES THAT THE LICENSEES SHALL, IF THE GOVERNMENT SO REQUIRES, GRANT MAJORITY PARTICIPATION TO THE STATE IN ALL FIELDS DISCOVERED UNDER THOSE LICENSES.

3. THE COMPANIES WILL BE INVITED TO ENTER INTO DISCUSSIONS WITH THE GOVERNMENT ABOUT MAJORITY STATE PARTICIPATION IN EXISTING LICENCES FOR COMMERCIAL FIELDS.

4. A BRITISH NATIONAL OIL CORPORATION WILL BE SET UP THROUGH WHICH THE GOVERNMENT WILL EXERCISE ITS PARTICIPATION RIGHTS.

5. THE GOVERNMENT'S POWERS TO CONTROL PHYSICAL PRODUCTION AND PIPELINES WILL BE EXTENDED.

6. A SCOTTISH DEVELOPMENT AGENCY WILL BE SET UP AND THERE WILL BE PARALLEL ARRANGEMENTS FOR WALES. EACH OF THE ABOVE POINTS IS DISCUSSED IN THE FOLLOWING PRELIMINARY ASSESSMENT.

#### INTRODUCTION:

THE GOVERNMENT'S WHITE PAPER IS A THOROUGHLY POLITICAL DOCUMENT PUBLISHED IN A PRE-ELECTION PERIOD. ITS FIRST WORDS REFER TO THE LABOR PARTY ELECTION MANIFESTO OF THIS PAST WINTER. ONLY AFTER THE NEXT ELECTION IS HELD, POSSIBLY IN OCTOBER, WILL THE TRUE COURSE OF BRITISH POLICY ON OFFSHORE OIL AND GAS DEVELOPMENT BE ABLE TO BE CHARTED WITH ANY CERTAINTY.

FOR THE MOMENT, IT IS CLEAR THAT LABOR HAS FORESWORN;

A) THE MORE EXTREME APPROACH OF 100 PER CENT "PARTICIPATION" AND, B) (WHICH APPEARS MORE LIKELY) THE FORMATION OF A NATIONAL HYDROCARBONS CORPORATION THAT WOULD ACT AS A MONOPOLY BUYER OF NORTH SEA CRUDE. AT THE SAME TIME, HOWEVER, LABOR HAS GONE FURTHER THAN ANY PAST OR PROSPECTIVE

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TIVE CONSERVATIVE OR CONSERVATIVE-LIBERAL COALITION GOVERNMENT WOULD BE LIKELY TO GO ON ESSENTIALLY IDEOLOGICAL GROUNDS. TO EXERT GREATER CONTROL OFFSHORE IT IS UNNECESSARY TO SEEK MAJORITY PARTICIPATION IN EXISTING AND FUTURE LICENSES OR TO ESTABLISH A BRITISH NATIONAL OIL CORPORATION WHICH, IN ADDITION TO MANAGING ANY HMG "CARRIED INTEREST", WILL BE EMPOWERED TO EXTEND ITS ACTIVITIES TO THE REFINING AND DISTRIBUTION OF OIL.

ANOTHER POINT OF DIFFERENCE IS DEVELOPMENT VERSUS DEPLETION POLICY. A CONSERVATIVE GOVERNMENT WOULD NOT EMPHASIZE DEPLETION AND WOULD STRESS THE NEED FOR RAPID DEVELOPMENT ABOVE ALL ELSE. LABOR IS ALREADY LOOKING TO THE TIME WHEN SELF-SUFFICIENCY WILL BE REACHED AND GOVERNMENT MUST BE PREPARED TO IMPOSE CONSERVATION MEASURES. IN THIS CONTEXT, IT SHOULD BE NOTED THAT THE SENTIMENTS OF SCOTTISH VOTERS WHO WANT TO HUSBAND "SCOTLAND'S OIL" FOR

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AS LONG AS POSSIBLY MAY REINFORCE LABOR'S OWN INSTINCTIVELY NATIONALISTIC POSTURE. NEVERTHELESS, IT IS DOUBTFUL LABOR CAN EVER WIN OVER SCOTTISH NATIONALIST SUPPORT FOR ITS NORTH SEA OIL POLICY. WHILE A STILL SOMEWHAT NEBULOUS SCOTTISH DEVELOPMENT AGENCY FINANCED BY THE UK EXCHEQUER MAY SATISFY MORE MODERATE SCOTS, LABOR OR THE CONSERVATIVES COULD PLACATE THE SCOTTISH NATIONALISTS ONLY BY DECLARING NORTH SEA OIL TO BE SCOTTISH AND AGREE-

ING TO DEVELOP IT AT A RATE MORE OR LESS ATTUNED TO SCOTTISH INSTEAD OF BRITISH NEEDS. THIS IS A POLICY NO GOVERNMENT AT WESTMINSTER COULD EVER PURSUE. AT SOME POINT HOWEVER, IT MAY BECOME NECESSARY TO GIVE SCOTLAND A SUBSTANTIAL AND DIRECT FINANCIAL INTEREST IN NORTH SEA TAX REVENUES, IN ORDER TO CHECK THE APPARENTLY GROWING SUPPORT FOR THE NATIONALIST PARTY. WALES COULD PRESENT A SIMILAR BUT MORE REMOTE PROBLEM.

THE MAIN AREA OF SUBSTANTIAL AGREEMENT BETWEEN THE CONSERVATIVES AND LABOR PROBABLY IS TAXATION POLICY. THE  
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CONSERVATIVES HAVE STATED THEY WOULD HAVE INTRODUCED AN "EXCESS REVENUE" TAX SO THAT THE TOTAL HMG TAKE WOULD REACH BETWEEN 70 AND 80 PER CENT OF PROFITS. LABOR IS LIKELY TO ACT IN SIMILAR FASHION, ALTHOUGH THE TYPE OF TAX IMPOSED MAY DIFFER.

ASSUMING DISCUSSIONS DO LEAD TO NEGOTIATIONS WITH THE COMPANIES AT SOME STAGE, THE AMOUNT AND TERMS OF COMPENSATION ARE BOUND TO BE A CONTENTIOUS ISSUE.

## 2. TAX POLICY

ALL PARTIES INVOLVED IN NORTH SEA DEVELOPMENT HAVE LONG SINCE ACCEPTED THE INEVITABILITY OF INCREASED TAXATION. THE DRAMATIC INCREASE IN OIL PRICES OVER THE PAST YEAR HAS MADE THIS A CERTAINTY. BUT THE WHITE PAPER LEAVES UNANSWERED IMPORTANT QUESTIONS AS TO THE LEVEL AND TYPE OF TAX WHICH IS TO BE SUPER-IMPOSED ON THE EXISTING CORPORATION TAX. AN "EXCESS PROFITS" TAX WITH THE DEGREE OF SEVERITY VARYING WITH THE PRODUCTIVITY OF DIFFERENT FIELDS IS ONE POSSIBLE APPROACH. THIS WOULD RESULT IN THE LARGER FIELDS CARRYING THE GREATER TAX BURDEN AND ALLOW THE MORE MARGINAL FIELDS TO BE DEVELOPED. A STRAIGHT BARRELAGES TAX WOULD HAVE THE OPPOSITE EFFECT. ANOTHER ASPECT IS WHETHER TAX LEGISLATION WILL BE FLEXIBLE ENOUGH TO TAKE INTO ACCOUNT THE DRAMATICALLY RISING AND VARYING COSTS INVOLVED. IN ANY EVENT, UNTIL THE TAX SITUATION IS CLARIFIED BY THE CHANCELLOR OF THE EXCHEQUER, SMALLER INDEPENDENT COMPANIES, BANKS AND OTHER INSTITUTIONS MIGHT DELAY FINANCING AND THIS IN TURN COULD DELAY SOME EXPLORATION AND DEVELOPMENT ACTIVITIES. THERE ALSO WILL BE SPECIAL CORPORATION CHANGES DESIGNED TO ELIMINATE THE OFFSETTING OF ARTIFICIAL TAX LOSSES INCURRED IN OTHER PARTS OF THE WORLD BY AN OIL COMPANY "GROUP". THIS MATTER, WHICH IS TREATED AT LENGTH IN THE WHITE PAPER, IS OF NO REAL INTEREST TO US FIRMS OPERATING IN THE UK SINCE THE PREFERRED TREATMENT AFFORDED UNTIL NOW WAS ONLY CLAIMABLE BY COMPANIES DOMICILED IN BRITAIN SUCH AS SHELL, BP AND BURMAH. THE CONCEPT OF A "RING FENCE" AROUND THE NORTH SEA WILL, HOWEVER, PREVENT ALL OIL COMPANIES FROM

OFFSETTING LOSSES ON MARKETING OR REFINING OPERATIONS IN  
THE UK HOME MARKET AGAINST NORTH SEA PROFITS.

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3. MAJORITY GOVERNMENT PARTICIPATION AS A CONDITION OF  
FUTURE LICENSES

LITTLE ATTENTION HAS BEEN FOCUSED ON THE PROVISION FOR  
GOVERNMENT PARTICIPATION AS A CONDITION OF THE AWARD OF  
FUTURE LICENSES. MOST OBSERVERS ASSUME THIS OPTION IS  
LIKELY TO BE PICKED UP IF THE LABOR PARTY IS IN POWER  
WHEN THE NEXT LICENSING ROUND TAKES PLACE. BUT SINCE  
THERE IS LITTLE PROSPECT OF ANOTHER ROUND BEFORE LATE  
1975 AT THE EARLIEST, THIS IS SEEN AS A SOMEWHAT REMOTE  
PROBLEM TO BE DEALT WITH ONCE DISCUSSION ABOUT PARTICIPA-  
TION IN EXISTING LICENSES HAS TAKEN PLACE.

4. MAJORITY GOVERNMENT PARTICIPATION IN EXISTING  
LICENSES

THERE IS ALMOST UNIVERSAL OPPOSITION AMONG THE OIL COMMUN-  
ITY TO THE IDEA OF RENEGOTIATING EXISTING LICENSES TO  
PROVIDE FOR MAJORITY STATE PARTICIPATION. US INDUSTRY  
REPRESENTATIVES IN PRIVATE (AND PRESS ARTICLES OVERTLY)  
ARE QUICK TO NOTE THAT ANY HMG ATTEMPT TO FORCE "VOLUN-  
TARY NEGOTIATION" MIGHT - OR OUGHT TO - PUT AT RISK BP'S  
ALASKAN INTERESTS. ONLY SHELL HAS OPENLY ATTACKED THE  
PROPOSAL, POINTING OUT "WE DO NOT BELIEVE STATE PARTICIPA-  
TION WOULD IMPROVE EITHER THE TECHNICAL OR ADMINISTRATIVE  
EFFICIENCY OF DEVELOPMENT PROGRAMS." SHELL ALSO QUES-  
TIONED - AS HAS FORMER PM HEATH - THE WISDOM OF SPENDING

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2 BILLION POUNDS TO OBTAIN A 51 PER CENT SHARE FOR HMG. SHELL FOUND HARD TO SEE HOW THE STATE COULD INVOLVE ITSELF IN DETAILED TECHNICAL DECISION-MAKING WITHOUT TAKING ON AN ENORMOUS STAFF OF TECHNICIANS AND ENGINEERS ALREADY IN SHORT SUPPLY AND WARNED THAT IF THE STATE TAKES ON THE ROLE AND IS UNABLE TO PLAY IT EFFICIENTLY THERE IS A REAL DANGER THAT OFFSHORE DEVELOPMENT WILL BE SLOWED DOWN. MOST INDUSTRY REPRESENTATIVES ARE CONCERNED AT PRESENT WITH THE PROPER TACTICS TO PURSUE IN DELAYING SUBSTANTIVE DISCUSSION WITH HMG ON THIS ITEM UNTIL AFTER THE NEXT ELECTIONS NOW FORECAST FOR SEPTEMBER-OCTOBER 1974. AS A PRACTICAL MATTER, SENIOR HMG CIVIL SERVANTS INTIMATE THEY EXPECT LITTLE PROGRESS TO BE MADE BEFORE THE ELECTION.

THE DEGREE OF REGULATORY CONTROL TO BE EXERCISED BY THE BNOC, IN ADDITION TO REPRESENTING THE GOVERNMENT'S MA-  
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JORITY PARTICIPATION INTEREST WHATEVER THIS MAY BE, WILL BE DETAILED IN LEGISLATION TO BE SUBMITTED AS SOON AS POSSIBLE TO THE PARLIAMENT. CONSIDERABLE CONCERN HAS BEEN EXPRESSED, AS EXEMPLIFIED BY THE SHELL STATEMENT CITED PREVIOUSLY, ABOUT THE INTENTION TO BUILD UP "A POWERFUL AND EXPERT SUPERVISORY STAFF THAT WILL ENABLE IT TO PLAY AN ACTIVE PART IN THE FUTURE DEVELOPMENT, EXPLORATION AND EXPLOITATION OF THE CONTINENTAL SHELF."

6. EXTENSION OF POWERS OF CONTROL OVER OFFSHORE OPERATIONS

THERE IS LITTLE TO QUARREL ABOUT RESPECTING THE GOVERN-

MENT'S INTENTION TO BE ABLE TO CONTROL THE RATE OF OIL PRODUCTION, RECEIVE ROYALTY OIL IN KIND, CONTROL PIPELINE DEVELOPMENT AND REQUIRE MORE INFORMATION ABOUT THEIR EXPLORATION AND DEVELOPMENT ACTIVITIES. THERE IS SOME CONCERN, HOWEVER, ABOUT THE SEEMINGLY PREMATURE EMPHASIS ON CONTROL OF PRODUCTION FOR PURPOSES OF DEPLETION POLICY.

BRITAIN AN UPPER LIMIT ON NORTH SEA PRODUCTION, IT COULD BE ARGUED THAT THE PACE AT WHICH FUTURE LICENSES ARE ISSUED SHOULD BE SLOWED OR EVEN HALTED FOR A CONSIDERABLE PERIOD. RELIABLE ESTIMATES INDICATE THAT ON THE BASIS OF COMMERCIAL FIELDS ALREADY DISCOVERED, BRITAIN COULD REACH AND MAINTAIN SELF-SUFFICIENCY FOR A PERIOD OF 5 YEARS DURING THE EARLY 1980S.

7. ESTABLISHMENT OF A SCOTTISH DEVELOPMENT AGENCY  
THERE ARE FEW SPECIFIC DETAILS OF THE NEW AGENCY GIVEN IN THE WHITE PAPER. ITS PRECISE ORGANIZATION, FUNCTIONS AND POWERS ARE TO BE WORKED OUT AND LEGISLATION PRESENTED TO THE PARLIAMENT.

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## Message Attributes

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